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No. 14-614

In the
Supreme Court of the United States

DOUGLAS R.M. NAZARIAN, ET AL.,
Petitioners,

v.

PPL ENERGYPLUS, L.L.C., ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

SUPPLEMENTAL BRIEF FOR PETITIONERS

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States are charged with ensuring local electric reliability. Their ability to provide long-term, contract rate support to willing generation developers is critical to achieving this objective. Generation development is capital-intensive, and often requires (as it did here) multi-hundred-million-dollar investments in facilities with decades-long lifespans. Entities investing that kind of capital frequently demand long-term rate stability.

In regions with central wholesale markets, states can provide stability by requiring retail utilities to buy a generator's output and then re-sell it into the market, *or* can achieve the same result by requiring retail utilities to contract with generation developers, who sell their output directly into the market. Spurred by opponents of new supply, the decisions below wrongly held that the latter structure is field-preempted state wholesale rate-setting, a rationale that necessarily invalidates both approaches, crippling states' ability to develop needed generation. The Fourth Circuit also erred in holding that the challenged state efforts illegally suppress wholesale market prices.

The decisions twist the Federal Power Act (FPA), contradict each other, controvert prior decisions of this Court and the Federal Energy Regulatory Commission (FERC), undermine the "essential role of contracts" in stabilizing prices and supporting investment,[1] and obstruct important state energy policies. While portrayed as limited, the decisions' impact is great—and growing—in an area where long-term investment and certainty are critical. Copycat suits are killing generation projects before the litigation is resolved.

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[1] *NRG Power Mktg., LLC v. Me. Pub. Utils. Comm'n*, 558 U.S. 165, 174 (2010) (*NRG*).

Petitioners, supporting states, and the association of all state utility regulators agree: States and industry need the Court to provide clarity now, especially as the Nation's aging generation supply is undergoing fundamental change. The Government provides no sound reason to withhold it.

I. The decisions are stopping needed new generation and undermining state policies.

The Government contends that the decisions are limited to their facts, and unlikely to result in preemption of other state-mandated contracts. U.S. Br. 20-23. Those assertions cannot be reconciled with the decisions' sweeping reasoning, which has already undermined the efforts of Maryland and New Jersey and more broadly threatens state usage of an essential tool to shape generation portfolios: long-term contracts with willing, state-selected sellers. This is not speculation; it is already happening.

Litigants around the country—including existing generation owners who benefit from restricting supply—have seized on these decisions to attack projects outside New Jersey and Maryland. Our certiorari petition detailed lawsuits challenging mandated purchases in Connecticut and Massachusetts. 14-614 Pet. 20-21. In New York, opponents cited the decisions to deter state regulators from adopting generation-development programs. *Id.* at 21-22 & nn.22-23. Similar challenges are pending elsewhere.[2]

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[2] *E.g.*, *Application of Ohio Power Co. for Auth. to Establish a Standard Serv. Offer Pursuant to R.C. 4928.143, in the Form of an Elec. Sec. Plan*, 319 P.U.R.4th 175, 196 (Pub. Utils. Comm'n of Ohio 2015) (deciding on other grounds not to approve purchase).

The Government observes that no court has yet followed the decisions and one district court distinguished them. U.S. Br. 22. But the supposed distinction—that New Jersey and Maryland purportedly "distort[ed]" the wholesale market but Connecticut did not, *see id.* at 23—addresses only the Fourth Circuit's conflict-preemption holding, and would not shield the Connecticut project (or others) from both courts' field-preemption holdings. Nor was the plaintiff's loss in Connecticut a deterrent—it filed a second lawsuit challenging a different mandated purchase.[3] And other plaintiffs have filed preemption suits against contracts supporting a Rhode Island offshore wind project[4] and a New York coal-to-gas conversion.[5]

This follow-on litigation exposes states and generation developers to substantial costs and uncertainty, chilling the enactment of new generation-support programs. Worse, needed projects are being terminated in their infancy, potentially mooting further adjudication. During the short time these petitions have been pending, preemption lawsuits have derailed at least two important projects:

In Massachusetts, retail utilities terminated contracts with the developer of a planned 130-turbine wind project just before the First Circuit heard argument, citing financing delays that the developer traced to the litigation. *Barnstable v. O'Connor*, 786 F.3d 130, 141-42 (1st Cir. 2015); Reply Br. 5 n.6. The trial court

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[3] *Allco Fin. Ltd. v. Klee*, No. 15-cv-608 (D. Conn. filed Apr. 26, 2015) (a different complaint, challenging a state program separate from the case discussed by the Government).

[4] *Riggs v. Curran*, No. 15-cv-343 (D.R.I. filed Aug. 14, 2015).

[5] *Entergy Nuclear Fitzpatrick, LLC v. Zibelman*, No. 15-cv-230 (N.D.N.Y. filed Feb. 27, 2015).

has held the remand proceedings in abeyance, and may dismiss them if the developer fails to overturn the contract termination.[6]

In New York, the state tried to prevent "mothballing" of a needed coal-fired generator earning insufficient revenue to continue operations.[7] The state required the local distribution utility to sign a short-term "support agreement," under which retail ratepayers pay the difference between the plant's market revenues and a fixed contract price.[8]

New York's preferred long-term solution was for the generator to convert the facility from coal to natural gas, but the generator would not perform this expensive overhaul without a long-term contract. When the state required the local distribution utility to enter such a contract, the generator's competitors sued, citing the decisions below.[9] Six months later, the generator announced it was mothballing the plant because the lawsuit "'created so much uncertainty for the project that we were forced to put it on hold . . . until some kind of resolution,'" which "'could take years,'"[10] leav-

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[6] Electronic Order, *Barnstable v. Berwick*, No. 14-10148 (D. Mass. July 6, 2015), ECF No. 70.

[7] *See* Julia E. Sullivan, *The Intersection of Federally Regulated Power Markets and State Energy and Environmental Goals*, 26 Fordham Envtl. L. Rev. 474, 509-10 (2015).

[8] *Id. See NRG*, 558 U.S. at 169; *Blumenthal v. FERC*, 552 F.3d 875, 879 (D.C. Cir. 2009). Such arrangements (referred to in some regions as "Reliability Must Run" agreements) are common, and structurally identical to (though for fewer years than) the Maryland and New Jersey contracts.

[9] *See Zibelman*, *supra* note 5.

[10] Jon Campbell, *Once Hailed by Cuomo, WNY Power Plant Plan Now 'On Hold,'* Democrat & Chronicle (Aug. 25, 2015), http://www.democratandchronicle.com/story/news/politics/blogs/

ing New York with precisely the outcome it sought to avoid: the loss of hundreds of needed megawatts of capacity.

II. The field-preemption holdings cannot be limited to their facts.

The decisions invalidate, as field-preempted state rate-setting, directives requiring retail utilities to contract with sellers willing to sell capacity to PJM for fifteen to twenty years at fixed rates rather than yearly participation at fluctuating auction prices. While purportedly limited, the decisions inevitably sweep broadly. Their fundamental premise—that a state effectively "sets" a wholesale rate by requiring retail utilities to contract with a willing seller—is irreconcilable with this Court's FPA precedent and cannot be limited to mandated contracts for only some FERC-jurisdictional sales. That incorrect core premise would outlaw a wide array of state programs providing long-term contract support to willing sellers of capacity or energy from sources that reflect state policies. *See* 14-614 Pet. 18-25.

While opposing certiorari, the Government does not defend the core holding that the states' contract directives were field-preempted because they "set" sellers' rates. The Government acknowledges instead that these holdings "could perhaps suggest an unduly broad rule of preemption." U.S. Br. 20. This concession, that the decisions' language can be read "in isolation" to preempt "whenever a State subsidizes . . . in-state generation" within a regional market (*id.*), underscores the need for this Court's review. The Government tries to

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vote-up/2015/08/25/once-hailed-by-cuomo-wny-power-plant-plan-now-on-hold/32337979/.

limit the decisions to their facts, but their reasoning does not allow it.

a. Unlike the decisions below, the Government suggests that state-mandated contracts might avoid preemption if they provide for sales *to a distribution utility* instead of PJM. U.S. Br. 19-20. That distinction is meaningless. The Government does not refute our showing that contracts for differences accomplish in one step what bilateral purchases and reoffers accomplish in two. 14-614 Pet. 7; Reply Br. 4 n.5. In each case, the generator receives the contract price and the utilities pay (or receive) the difference between contract and market prices. Nor is there any jurisdictional difference between sales to PJM and sales to distribution utilities. All are wholesale sales within FERC's field, so there can be no field-preemption distinction between directives to contract for one sale or the other.

The problem is not the contracts—it is that the decisions' core premise is wrong. Directing retail utilities to contract with willing sellers does not invade FERC's rate-setting field. The reasons inhere in the FPA and this Court's precedent. The FPA did not affect sellers' ability to set their own rates unilaterally or by contract, but made those rates subject to FERC's paramount—but reactive—review authority. *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 341 (1956); *Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527, 531 (2008) (*Morgan Stanley*). Consistent with this structure, Maryland and New Jersey exercised no authority over the sellers, who proposed their own rates and contracted willingly. And, but for the decisions below, FERC could have reviewed the contracts.

b. The Government tries to dodge this by claiming that "[t]he state-selected generators in these cases . . .

voluntarily gave up their right to set their own rate . . . when they entered the PJM auction and agreed to receive the clearing price." U.S. Br. 23-24. This assertion is unsupported, counter-factual, and contrary to *Atlantic City Electric Co. v. FERC*, 295 F.3d 1 (D.C. Cir. 2002), *mandate enforced*, 329 F.3d 856 (D.C. Cir. 2003). There, the D.C. Circuit reversed FERC's finding that transmission owners relinquished their rate-setting rights by participating in PJM, *Pa.-N.J.-Md. Interconnection*, 81 FERC ¶ 61,257, at 62,279 (1997), *reh'g denied*, 92 FERC ¶ 61,282 (2000), emphasizing that "the power to initiate rate changes rests with the utility and cannot be appropriated by FERC" or PJM. 295 F.3d at 10.

The Government identifies no express waiver of PJM auction sellers' rights to propose to sell to PJM at different rates (namely, the contract rate) and on different terms than the auction (*e.g.*, committing to sell into the PJM market for twenty years rather than retaining an annual option to exit the market). Any attempt to *require* a waiver would contravene *Atlantic City*. *Id.* at 15 ("FERC can point to no statute authorizing its requirement that the utility petitioners cede their statutory rights[.]").

In fact, there is no single permissible rate for sales to PJM. Instead of retiring, generators that are needed for reliability but earning insufficient market revenue to continue operations may file proposed rates for their sales to PJM. Such rates are filed as unexecuted contracts with PJM. *NRG*, 558 U.S. at 169; *Blumenthal*, 552 F.3d at 879. When FERC accepts and PJM signs such agreements, they function much like contracts for differences, supplementing the generator's market revenues (albeit usually for a shorter term). Faced with

Atlantic City-style arguments,[11] FERC has held that generators—not market operators—must have the right to set the rates in those agreements. *Midcontinent Indep. Sys. Operator, Inc.*, 148 FERC ¶ 61,057, P 92 (2014), *reh'g pending*.

Simply put, the states set no rates here; the selling utilities did. And they are free to agree to sell into PJM on a long-term basis at rates of their choosing.

c. The Government says that, under the decisions, states still *might* be able to support generation with *non*-contract incentives. Speculation about possible regulatory half-measures cannot justify depriving states of an essential tool in shaping their generation portfolios.

In *New York v. FERC*, 535 U.S. 1, 24 (2002) (internal quotation omitted), which the Government never mentions, this Court relied on FERC's finding that its landmark unbundling order did not "affect . . . state authority in such traditional areas as . . . reliability of local service; . . . resource planning and utility buy-side . . . decisions[; and] . . . generation and resource portfolios." Buy-side decisions affecting state generation portfolios are centrally at issue here.

This Court has acknowledged the "important role of contracts" in stabilizing prices and promoting investment, which "ultimately benefits consumers, even if short-term rates for a subset of the public might be high." *Morgan Stanley*, 554 U.S. at 551; *see also NRG*, 558 U.S. at 173-74. Until now, no court had held that

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[11] Ill. Power Mktg. Co. & Ill. Power Res. Generating, LLC, Motion to Intervene, Limited Protest, Supplement to Complaint, and Request to Consolidate Proceedings 8-9 (Feb. 20, 2014), http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=13467262.

the FPA forecloses states from requiring retail utilities to enter such contracts. Indeed, the contracts at issue in a companion to *Morgan Stanley* were mandated by California. *Pub. Utils. Comm'n of Cal. v. FERC*, 474 F.3d 587, 591 (9th Cir. 2006), *vacated sub nom. Sempra Generation v. Pub. Utils. Comm'n of Cal.*, 554 U.S. 931 (2008).[12] "[T]ax relief" and "accelerating permit approvals" (U.S. Br. 11) would not have ameliorated California's energy crisis. The decisions below were wrong to restrict states to such meager tools.

d. The Government's reliance on *ONEOK, Inc. v. Learjet, Inc.*, 135 S. Ct. 1591 (2015), is misplaced. That decision recognized the FPA's protection of state authority over generation and retail rates and the limits of the field-preemptive effect of FERC jurisdiction. The state actions here are even more clearly on the state side of the line than were the antitrust suits in *ONEOK*. Here, the states sought to achieve permissible generation-development goals by regulating state-jurisdictional distribution utilities, not FERC-jurisdictional sellers. *Contra Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293 (1988) (state regulation of interstate natural gas companies' securities in order to constrain their rates). That permissible state regulation affects matters within FERC's jurisdiction does not render it field-preempted. *ONEOK*, 135 S. Ct. at 1599-1600. That is especially so here, where state retail regulation produces contracts that FERC may review, providing for sales into PJM upon such terms as FERC permits.

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[12] California ordered state agencies instead of distribution utilities to execute the contracts, because the utilities were "collapsing." *Pub. Util. Dist. No. 1. v. FERC*, 471 F.3d 1053, 1070 (9th Cir. 2006), *aff'd sub nom. Morgan Stanley*.

III. The Government's conflict-preemption rationale contradicts FERC's orders.

The Government's conflict-preemption argument—that state programs could suppress wholesale prices "even after the Commission's 2011 amendment to the minimum-offer-price rule" (U.S. Br. 16-17)—is not credible. It collaterally attacks FERC's rulings (affirmed by the Third Circuit) that those amendments were sufficient to ensure reasonable prices, and would outlaw important state programs that FERC and the Third Circuit held states could pursue. *PJM Interconnection, L.L.C.*, 135 FERC ¶ 61,022, *on reh'g*, 137 FERC ¶ 61,145 (2011), *petition for review denied sub nom. N.J. Bd. of Pub. Utils. v. FERC*, 744 F.3d 74 (3d Cir. 2014).

In *PJM*, FERC responded to the state programs at issue here by subjecting state-backed resources to auction-bidding rules that prevent artificial price suppression. The rules require offers below a benchmark to be cost-justified—*excluding state subsidies*. FERC concluded that if such cost-based offers clear the auction (as CPV's did), then the resources are "economic," "competitive," and "[do] not artificially suppress market prices," regardless of the subsidy. 135 FERC ¶ 61,022, PP 175, 177. FERC held that these rules "reconcile[d]" any "tension" between state and federal programs, allowing states to pursue "policies and objectives [that] may not be recognized" in the federal market, without artificially suppressing wholesale prices. 137 FERC ¶ 61,145, PP 3-4.

The Third Circuit affirmed, stating that:

> [W]hat FERC has . . . done here is permit states to develop whatever capacity resources they wish . . . while . . . prevent[ing] the state's choic-

> es from adversely affecting wholesale capacity rates.

N.J. Bd. of Pub. Utils., 744 F.3d at 98. That should have ended any price-suppression argument.

The Government nonetheless effectively asserts that FERC's orders were deficient, in that price suppression remains possible because subsidies could enable "a state-selected generator [to] bid the minimum-offer default price—even if [its] actual costs are higher than the default price." U.S. Br. 16. But none of the courts below addressed that circumstance. And FERC addressed concerns about offers escaping review when it set the offer-review trigger. FERC's chosen threshold level "reasonably balance[d]" the competing concerns. 135 FERC ¶ 61,022, P 66.

The contention that there are "factual findings of the courts below" concerning price suppression that "[p]etitioners . . . cannot escape," U.S. Br. 16, is wrong. The Maryland district court made no such findings; the Fourth Circuit asserted the price-suppression idea on its own. 14-614 Pet. App. 25a.[13] The New Jersey district court made such findings, but they were based on the premise that it knew better than FERC whether the revised minimum offer price rule eliminated any state-FERC conflict. 14-634 Pet. App. 94a. The Third Circuit, which had affirmed FERC's orders, did *not* adopt the conflict theory—even after the Government urged it to do so.

FERC drew a just-and-reasonable line between the risk of bids that are too low and the cost of requiring

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[13] The Maryland district court explained that CPV's bid was cost-justified, *id.* at 125a-126a, further belying the Government's concern (invented contrary to FERC's orders) about below cost, benchmark-level bidding.

higher ones. The benchmark FERC chose was high enough that offers for the resources at issue here were reviewed and adjusted by PJM. All but one resource cleared the auction on that basis, and FERC deemed the result just and reasonable.[14] It is not for Government litigators or courts to second guess FERC's decisions or the resulting market outcomes. *City of Tacoma v. Taxpayers of Tacoma*, 357 U.S. 320, 336 (1958). The Court should not heed a Government brief that is "plainly erroneous [and] inconsistent with [FERC's] regulat[ory] [orders.]" *Christopher v. SmithKline Beecham Corp.*, 132 S. Ct. 2156, 2166 (2012) (internal quotations omitted).

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[14] *PJM Interconnection, L.L.C.*, 143 FERC ¶ 61,090, P 143 (2013), *reh'g pending*.

CONCLUSION

The petition should be granted.

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